BEAR
STEARNS

Panel Five

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Panelists

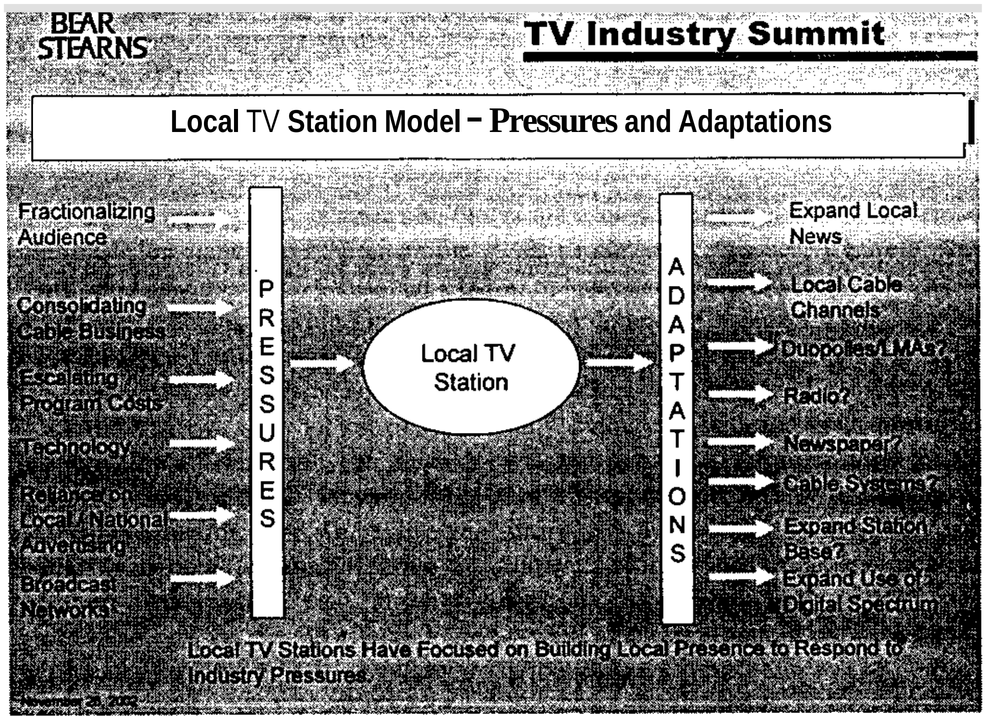
Jim Keelor — President and Chief Executive Officer, Liberty Corp.

Paul McTear — President and Chief Executive Officer, Raycom

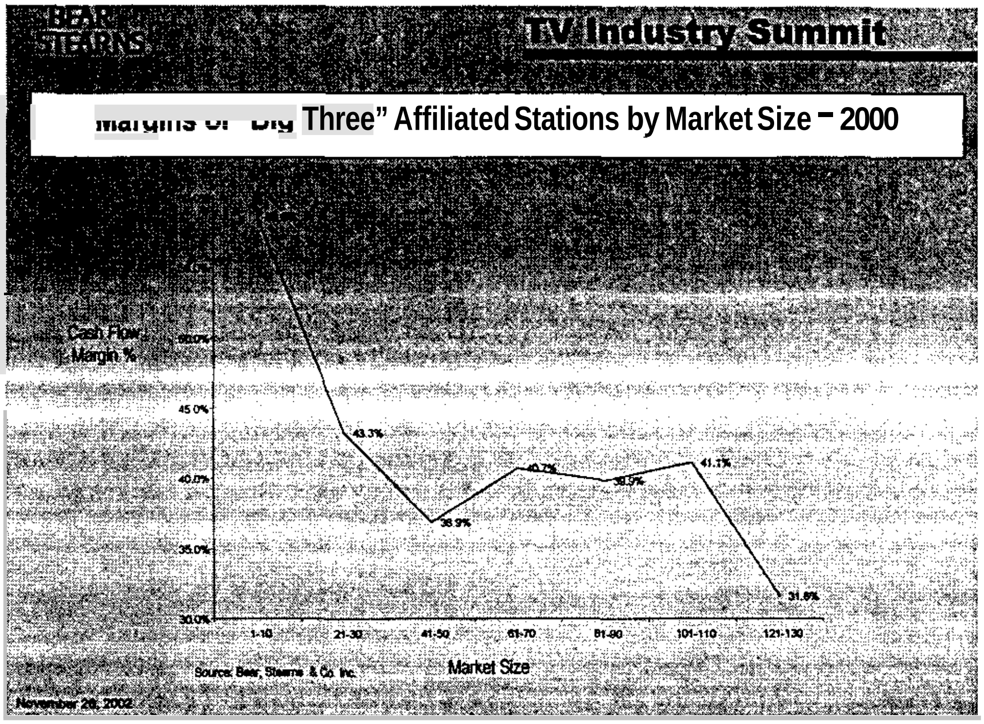
Perry Sook — President and Chief Executive Officer, Nexstar

Jim Yager — Chief Operating Officer, Gray Television

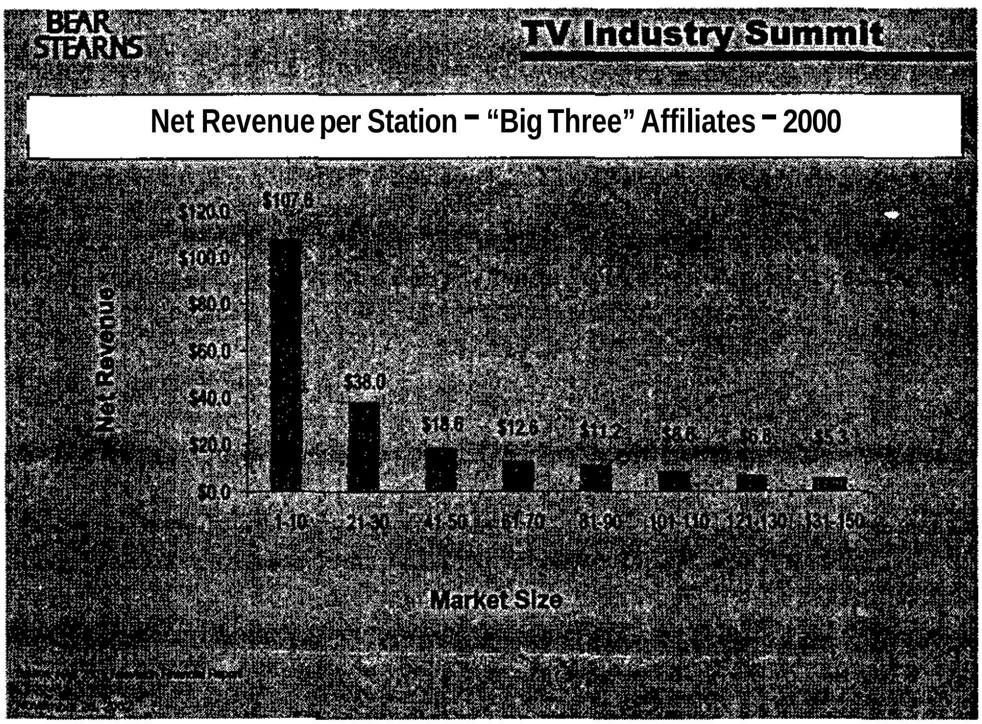
Panel Time: 1:15 P.M. to 2:15 P.M. E.S.T.



Victor Miller: We're going to start the discussion on panel five now, which is small-market television economics. Now, we're going to **look** at how the smaller- and midsize-market players are adapting to the exact same pressures we talked about with some **of** our larger players this morning. To do this, we've got Jim Keeler, president and CEO of Liberty Corp.; Paul McTear, president and CEO of Raycom; Perry Sook, president and CEO of Nexstar; and Jim Yager, the chief operating officer at Gray Television. Thank you all for joining **us.**



Here are the margins of the big three affiliated stations by market size. This is from the NAB's report they do every year on the financial report for the television business. In 2000, the margins in the top ten big three network affiliates approximated 59%; in markets 121 through 130, the margins approach 32%. This panel will focus on the economics of small-market broadcasters, and we will seek to solve the 27% margin disparity riddle between large and small markets.



First of all, let's look at the average revenue per station. As you can see, in markets one through ten, you have about $108 million, all the way down to 131 through 150, an average of $5.3 million. Perry, I'd like to start it with you. In general, there are fewer TV stations in the markets in which you operate, which should be a positive. Despite this, the average net revenue per station in your markets is nearly 20 times less than it is in big markets. However, the top ten markets represent nearly 30% of all U.S. TV households, and markets 131 through 150 represent 3% of TV households. So, that means there are ten times more people in the big markets, but getting 20 times more average revenue. What is going on in that . . . what is the lesson here?

Perry Sook: First of all, that says to me that there is an opportunity. I think if you look at the 100-plus markets, or the smaller markets, the ownership by ownership group is much more — it's been much more fragmented, much more diverse. I think, first of all, there is a natural bias toward buying larger markets. And when the top 30 markets represent in excess of 40% of all television household, and the bottom third of these markets represent 3%, I think that it's just been easier, historically, for a media buyer to start at the top of the list and stop when you've reached three-quarters of the country, which may well he markets 80 to 90, at that point. But I do think there's opportunity in those numbers because I don't think that most family-run and small broadcast groups have historically maximized the value of their assets.

Victor Miller: Anybody want to follow up on the panel on that point?

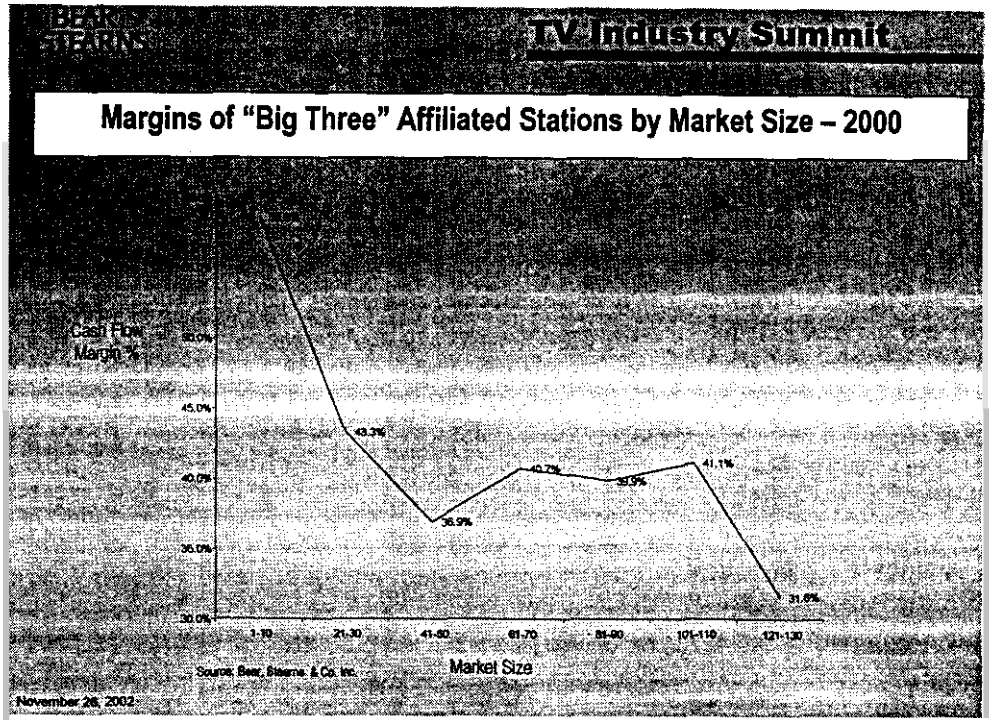
Jim Yager: I will because I think it speaks a great case for small-market duopoly. In the top ten markets, where you have these tremendous margins, you have duopoly situations. In the smaller markets, where we have been prohibited, kind of by law, held out of duopoly in any kind of fashion, we are struggling. And you have in the 120-130 market three news entities competing for news product, whereas in the top markets, you have a combination of CBS and UPN, and you have Fox with a kind of multitude of outlets. So, I think . . . by the way, a business with a 31.6% margin is not necessarily a bad business. A lot of people would like to have that, but at 31.6% compared to the 58.6% . . . certainly, I think, speaks a great case for a small-market duopoly.

Victor Miller: And again, keep in mind we're looking at . . . that was 2000, which was a banner year, so what does it look like in five years to keep that?

Jim Yager: I would say that when you see the 2001 numbers, that number will be down; it will be down considerably. But I think it will be in the top markets. I think something has to be done in the small markets to allow us to create duopoly situations.

Victor Miller: Any other follow points?

Jim Keelor: First of all, Victor, it is a scaled thing. I mean, New York would get $10,000 for a news spot; we get $500 in Lake Charles. So, a lot of small markets aren't even bought by national advertisers. The first thing you ask is, how deep is the buy going? You get down the market 75, they may cut it out. So, that ratio doesn't surprise me.



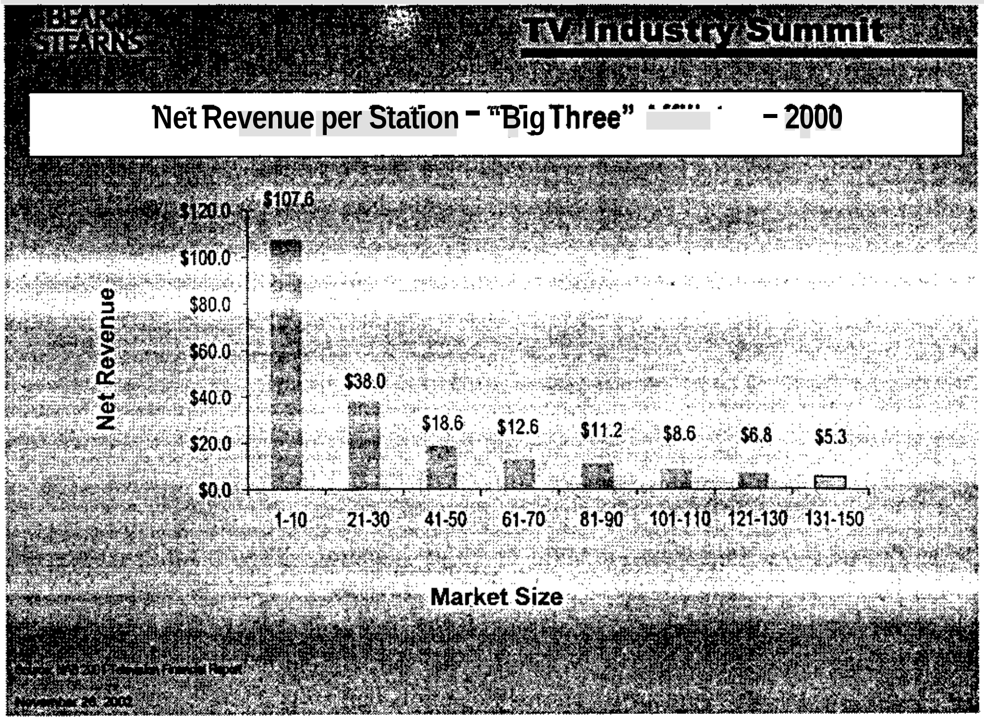
"And the duopoly model is exactly upside down. The big markets don't need the help. The small markets do."

What is of more concern to me was the first chart you showed, which showed the erosion of the profit margins. And I think — and, by the way, we have not suffered that kind of profit margin reversal in our company, even though we've lost a significant amount of compensation over a period of time. But I think that when you look at 2000, you had several things: you had loss of compensation, you had a disastrous fourth quarter, you had increased cost as you try to compete in the Internet and other platforms . . . and your network contracts also were more restrictive in terms of the kinds of preemptions, which allowed you to generate more revenue. So, if you look at the track of that margin erosion, I think there are legitimate reasons for it. But I think the really strong stations in the market maintain those margins by effective cost control, creative selling, and so forth and so on. But I agree with Jim that we can only sustain that for a short period of time. And the duopoly model is exactly upside down. The big markets don't need the help. The small markets do. We are competing in an environment of bits, bytes, and broadband, and as the regulators would have it, we have a string attached to two tin cans.

Victor Miller: Now, just to your point. A lot of you have really, really strong local stations. You have very attractive revenue shares. You've been able to buy and/or acquire that type of quality station group. What happens to the third-, the fourth-ranked station in a mid and small market? Paul, do you want to address that . . . do you have any of those in your portfolio, where it's a smaller market and the station really is not that strong? What's the marketplace in margins like for that station?

Paul McTear: I'm pleased to say I don't. I have some in markets larger than that, which would make it even more painful! But I think that the dilemma that a mid- to small-market operator faces, and to echo a little bit that's been said throughout the day, we participate pretty much in a fixed-cost business . . . that the television business is fixed for the most part. If you want to run your television station a certain way . . . if you want to bring to your audience a certain quality of news in editorials.

There are variables relating to sales and some other aspects, but the scalability of cost doesn't change **as** dramatically **as** the scalability of revenue.

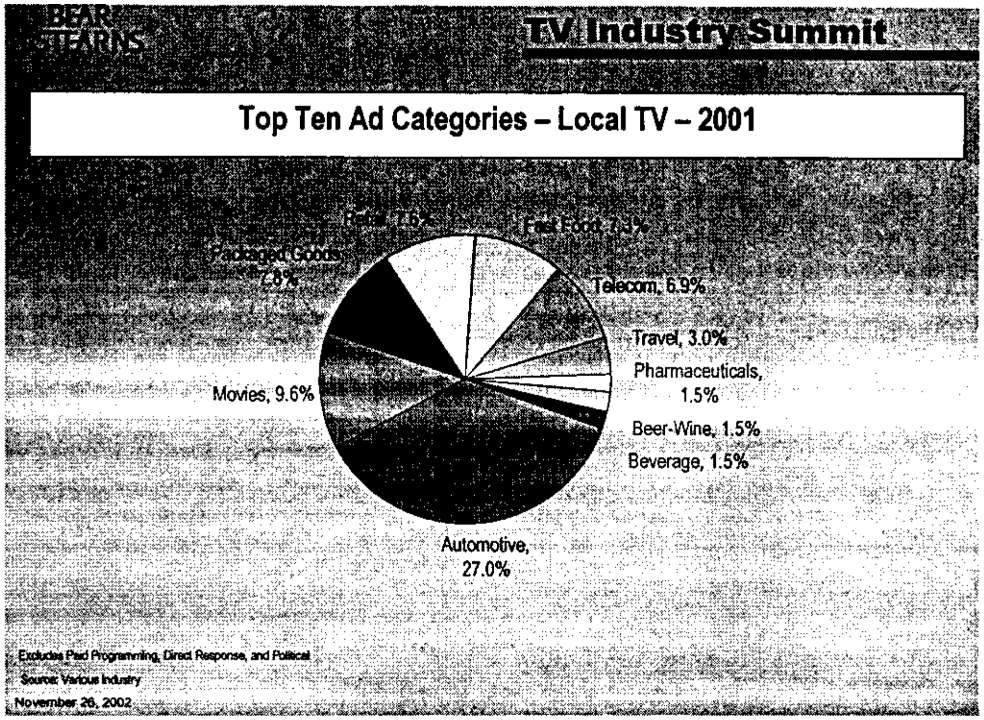


As you see in the chart, revenue of $107 million in the top bar and in the $5.3 million — and, yes, 31% EBITDA margins, as Jim said earlier, is still a good business. Well, let's not forget that's 31% of $5 million. That's not 31% of a $107.6 million — 1 think they're getting close to 60% [margins in larger markets]. So, that the free cash flow before capital dramatically shifts, depending on the commitment you make to what you bring to the marketplace from an editorial standpoint.

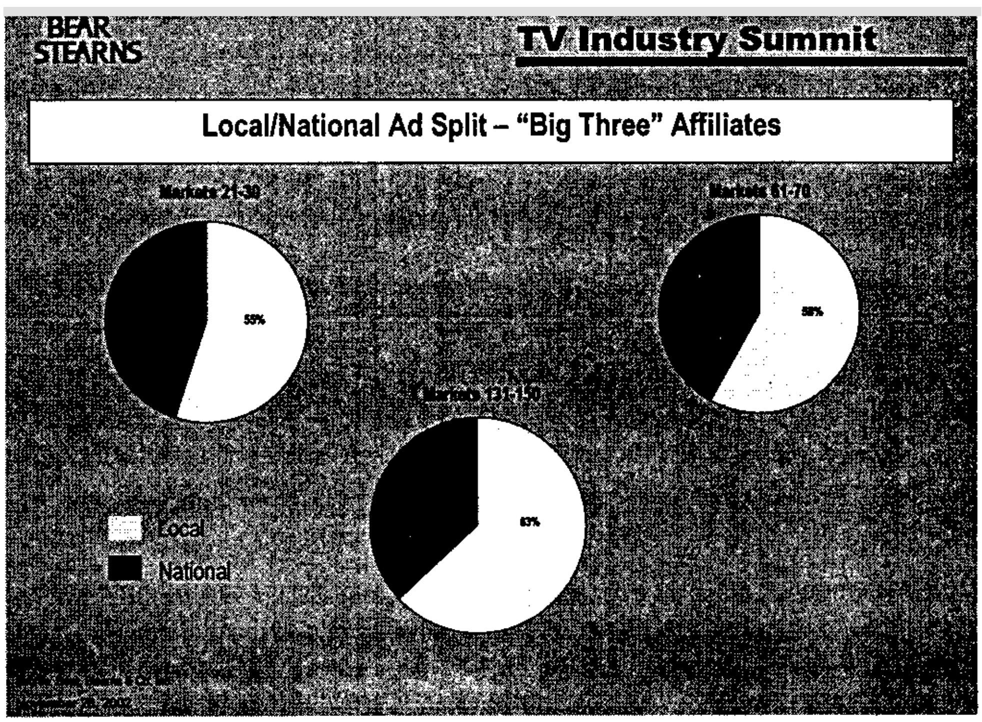
Victor Miller: So, your point is that $60 million cash flow for a top ten market (actually close to $60 million; 58.6% of $107.6 million in net revenue), and it's $1.5 million (31.6% of $5.3 million in net revenue); so it's 40x less cash flow. That's what your point is when you look. . . do the math.

> "I'm paying more to put **HDTV** on in market **198** in Kirksville, Missouri, than I did in Cleveland, Ohio. Yet the returns available to me are dramatically different."

Paul McTear: That's the first point. And the second point, 1 think to pick up something that Gary Chapman of LIN Television had said earlier when he compared his dilemma of Indianapolis to Fort Wayne where, I think, he said pretty real succinctly that in Indianapolis, my recovery on that capital, HDTV is two months' worth of cash flow. And in Fort Wayne, it was more than two years. And I'm paying **as** much to put HDTV in market 198 — infact, I'm paying more to put HDTV on in market 198 in Kirksville, Missouri, than I did in Cleveland, Ohio. Yet the returns available to me are dramatically different. We'll spend $58 million on DTV over the course of the two or three years worth of installation. So that the interest cost alone costs about $3 million worth of new operating costs next year, which means that I have to produce $8 million worth of cash, to cover my compliance with the **FCC** regulation with, at this point, no new sources to offset those uses.



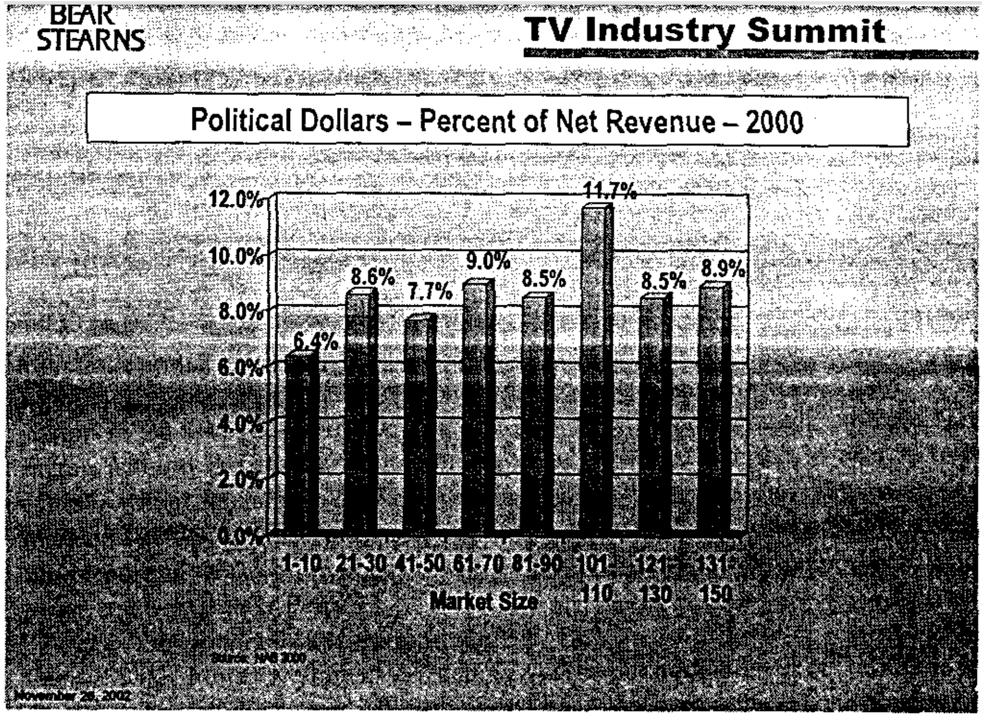
Victor Miller: Let's look at. . . we've seen the top ten ad categories.



In markets 20 through 31, 55% of the business is local, 45% national. When you get into your markets, some of the smaller to midsize markets, it's more like 63% local. Does this really go back to what Jim was saying? It's just that the number of advertisers that are willing to buy these markets is fewer? Is that accurate?

"Local advertisers aren't going to be cyclical with us; they're going to be there every year."

Jim Keelor: Well, I think they're fewer, but I think we have made it a priority for the last ten years to try to get our local share of business in the **70%** area for all the reasons mentioned before. It's cost controllable. These people aren't going to be cyclical with us; they're going to be there every year, unless the politicians come in and blow them away. A national advertiser may roll out a new product and may try for brand identification, but the local furniture dealer or the local car dealer. . . that's his community, he's going to be there, he's got to make his profit — television's the best way for him to do it. So, I mean, that's where our future growth is — not only on the air but on the Internet, which I hope we'll talk about later.



Victor Miller: Let's talk about one revenue stream, aside from the general advertising categories; let's talk about the political dollars. I want to ask Harry and Jim to comment about this. You guys have really done a great job in building your local news franchises. You're in a lot of capital markets, and they'll stay capital markets, Jim . . . where they represented about **6.4%** of a typical big three's revenue in markets one through ten, the numbers get into the 8.5%-12% range for markets north of 60-70. How do you view the political dollars? Is it an enemy? Is it a friend? Does it confuse what the core business looks like? Talk a little bit about this phenomena.

Jim Yager: Well, we love it in the even years and despise it in odd-numbered years because . . . I thought the earlier panel with some of the bigger-market operators made the point clearly. Number one, political is very unpredictable. You really sit down at the beginning of the year, and you kind of analyze all your markets — in our case, we've had ***25*** separate markets we tried to analyze. And we were right in about ***50%*** of them. That is, we thought there would be a good race in Colorado for the Senate seat that was held by Allard, and it turned out to be a very, very good race. We thought things would go on in the Midwest in Nebraska and in Kansas. And, quite honestly, we probably grossed as much as my airfare was coming here on that race. And that was about a $600,000 disappointment. So, political is totally unpredictable. Two years ago, in Lansing, Michigan . . . it was a ballot issue on school vouchers. And the unions got involved, the school district got involved, everybody got involved. And literally, you could not get a commercial spot on our air for almost a 45-day period. I think it's good; I think it's part of the process. Look, advertising of politicians has gone back and it's been dirty since George Washington ran for President. They trashed him about his false teeth and everything else back when he became the first President of the United States. So, political advertising is a way of life in this country. And television, and I think it was Gary Chapman, or was it Kevin O'Brien of Meredith Corp., made the point that we're an effective way for politicians to get an immediate kind of response from the public. I see it there for many years to come.

Victor Miller: Perry, why do you think the political dollars represent more of the revenue stream in these markets? And is that a sign of strength or concern or both? What is it?

"There is still displacement of regular advertising with heavy political advertising because we're not like newspapers — we can't go up a page when we have more demand."

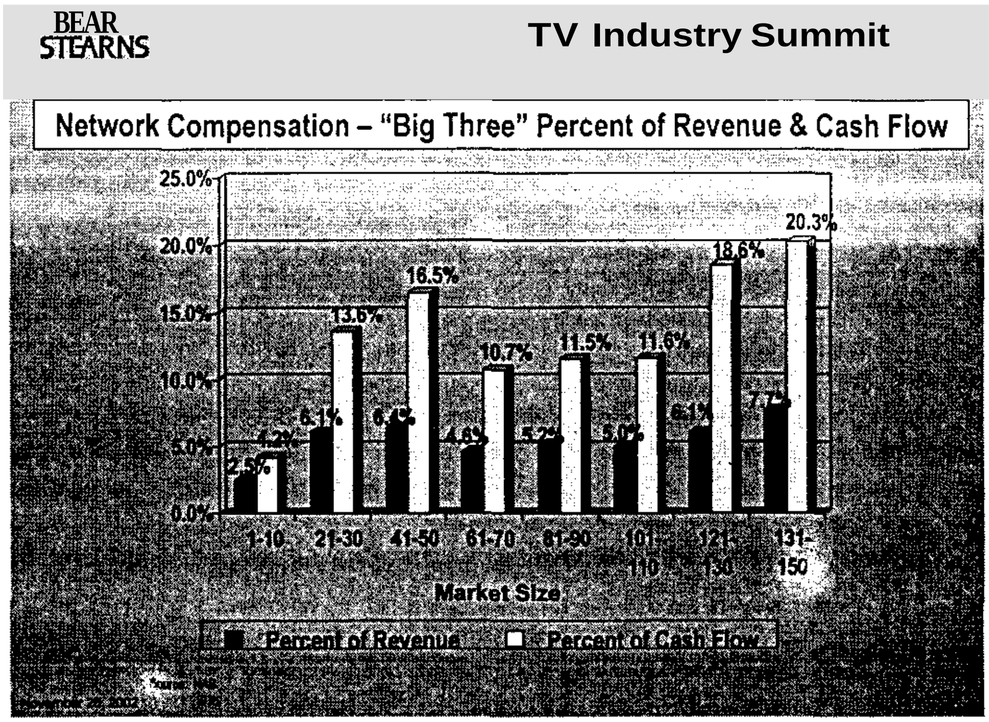
Perry Sook: My perspective would be that it's not by market rank; it's by geography. All races are local, and, for example, our company has a higher-than-average percentage of the industry contribution from political in the even years, based on the geographical distribution of our stations. When I started in the business, we used to think of political revenue as kind of extraordinary income; it was just gravy when it came. It is . . . a part of our business; it is recurring revenue. We have political revenue every year. We have spikes in the even-numbered years. And it is one category of our business that has grown at a compound annual growth rate of double digits, going back to the early 1990s — even farther than that, if you want to keep score. So, I don't see it as a negative at all. Jim is absolutely right. You don't sell political advertising; you traffic it, basically. And so, no salesperson at our company actively solicits political advertising; it's all handled by sales managers, and we have developed a system, I think, to maximize our yield on political; therefore, limit the amount of displacement. Having said that, there is still displacement of regular advertising with heavy political advertising because we're not like newspapers — we can't go up a page when we have more demand. We have a finite set of inventory. But we manage it, we see it as recurring, we look at the individual races that we expect to come up in a given year. When we last had that race, whether it was two years, four years, or six years ago, what were the dynamics? What was the spending pattern? And it is a recurring revenue source for us that we manage like any other revenue source. And its becoming. . . the money is so huge, it's over $1 billion this year — all spent on local television. As Jim said, I mean, it's basically direct response advertising. I want to influence the polls tomorrow, so I'll put ads on the air today; they have to run. And, if anything, I think it validates the capability of our medium to move product, move the needle, and influence opinion.

Victor Miller: Now, what kind of tension does this cause in your odd years when you're talking about 8%-12% of your revenues in an even-numbered year. How do you budget for that in odd-numbered years?

Jim Keelor: It makes for some interesting budget discussions with the station managers. I mean, that inventory, or 80% of it, is going to be filled with something. The question is rate. Those who criticize television broadcasters for gouging political candidates don't seem to understand that it's the candidates themselves and their parties that create the supply and demand in a free market. We've had candidates who called and complained to us because they couldn't get on the air, and the reason they couldn't is because their national party had just paid a preemptive rate to bump them off. So, we're the ones who are gouging. . .

Victor Miller: That's not a good sign, is it?

Jim Keelor: Yes, that happens a lot. But it doesn't . . . I mean, you do have to assume that a certain percentage of that inventory will be sold. The real issue is in a down year, the rate pressure will not be there to get the rates at the level that 'the politicians themselves drive them to during elections.



Victor Miller: Paul, let's talk about network compensation. **You** can see the big three percentage of revenue and cash flow. This is, again, from the NAB — National Association of Broadcasters' "Television and Financial Report." Basically, in the top markets — let's say, one through ten — 2.5%, on average, of the revenues of those stations are network comp. And if you just said that flows through dollar for dollar, that may be an incorrect statement? Tell me if I'm wrong looking at it that way. It would be about **4.2%** of cash flow. Now, get into markets 131-150. . . the percentage of revenue is more like **8%,** and the percentage of cash flow is over **20%.** Talk to us about what's been happening in network compensation . . . whether our analysis is roughly about right, and how the heck you change your model to adapt to this?

Paul McTear: Well, in my experience, I think your model is roughly right. And as the networks have said publicly, their goal is to zero network compensation. And with this, the little leverage that we middle- and small-market operators have . . . our job is to plan to offset the loss of that revenue on a going-forward basis. **Our** goal is that we put some money into an Internet-based business that provides service to all of

"We're probably looking at about $15 million as a company in network comp. It's a lot of money, and it flows to the bottom line."

our Web systems because we believe that we have an obligation to bring news and information to our audience no matter where they are — in front of the TV or in the home. Our goal in that was so that maybe, over time, we're able to establish some convergent selling to establish some revenue to offset the network comp in the three- to five-year time frame — not very ambitious, but I think for us, we're probably looking at about $15 million as a company in network comp. It's a lot of money, and it flows to the bottom line.

Victor Miller: Please, Perry, jump in.

Perry Sook: I — just a personal observation — I think we spend way, way, way too much time talking about this network compensation issue. If I were able to earn *$0.25* per sub per month in my universe, from just the top 25 MSOs . . . that would be three and a half times the amount of cash I have for network comp. And, for any network folks in the room, I'd be glad to make that trade tomorrow, if we were able to bargain collectively. We have renegotiated and renewed network affiliation agreements with stations that we own and also stations we've purchased. And you do get comp if you have leverage in the marketplace, if there are more networks than there are stations, and you threaten to leave. You can, it's negotiation, but it's not a growing segment of our business. Everybody seems to look at how much we paid to get that programming. Well, how much does the network want to pay for us to distribute their commercials is the way I think. A network affiliation agreement is nothing more than a glorified time brokerage agreement basically, from my perspective. We only operate in markets 50-150, and I can tell you that from our company, if you look at the dynamics from markets 61-70, that's about what network compensation means to us. The numbers have gone down . . . slightly. I don't think in our universe, our company's universe, it probably ever goes to zero, but I'd be glad to make a value exchange for a component or the opportunity to participate in a component that would grow. I mean, this is, it's a flat-line number. We lost far more from the bottom line last year due to softness in ad sales — a multiple of what would have happened if our network comp went away tomorrow. We're here; we're all a little shorter than we were a year ago. But it's still, it's not a fatal blow. And I think we spend way too much time talking about this tension element.

"We lost far more from the bottom line last year due to softness io ad sales — a multiple of what would have happened if our network comp went away tomorrow."

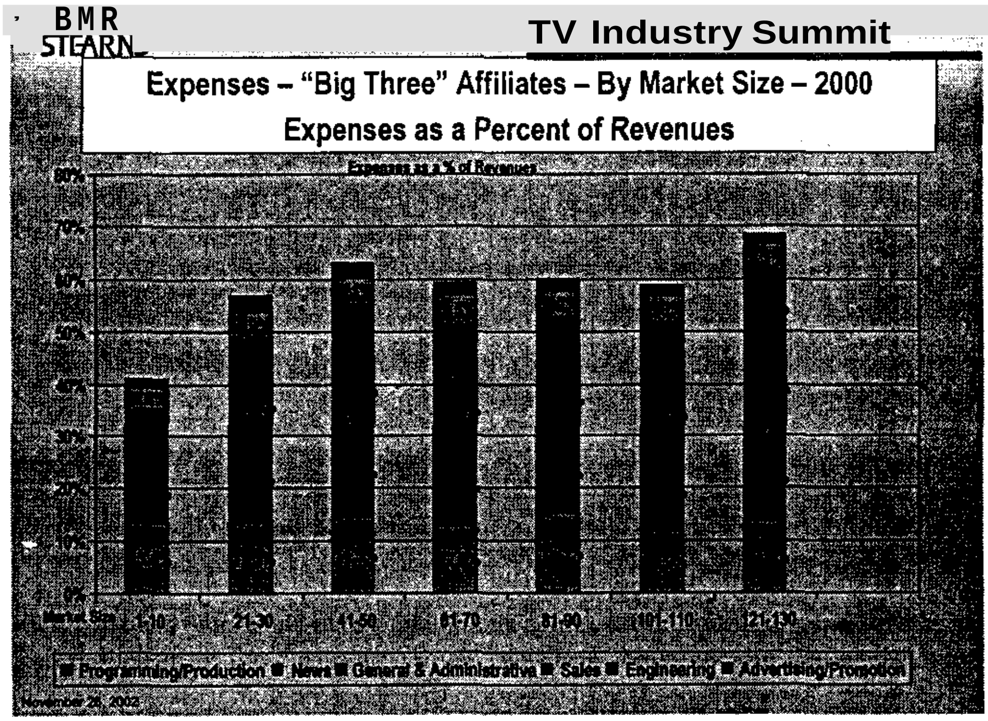
Jim Yager: And I think it's a little overexaggerated when it comes to the small- to midsize markets. This year, as a percent of our total revenue in Gray, network comp will be — and we divulged this on the road show, so I'm not telling you anything that's proprietary here — will be *2.6%* of our total revenue, Now, if, in four years, network comp goes away, and we have not offset that with aggressive local sales campaigns, then I would say we have truly failed. But our local growth has far exceeded the kind of loss that 2.6% would . . . I'd be a hell of a lot more worried about losing automotive than losing network comp.

"If, in four years, network comp goes away, and we have not offset that with aggressive local sales campaigns, then I would say we have truly failed."

Victor Miller: Well, now, how do you theoretically get paid now for your signal? If that's something you think that you deserve in the local marketplace? How concentrated are the MSOs in your business? What's the impact of the DBS business in your marketplace? Jim, you want to start?

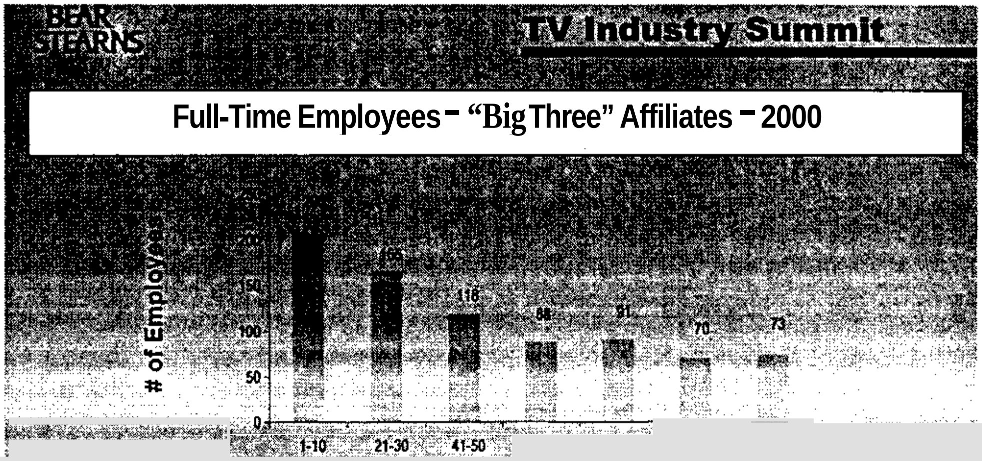
Jim Keelor: Well, I think a lot of us will share the same thing for DBS in that we are in smaller markets with large rural components. And I was looking at the statistics before I left. We're probably, on average, around **20%** DBS penetration. Interestingly enough, a couple of the cable folks with whom we do have a good relationship told us that during Ergen's [Charlie Ergen, CEO of EchoStar, a direct broadcast satellite operator] little misadventure up here, that they actually lost penetration in their competitive markets because they took their took their eye off the ball. Cable watches that very closely. I have calls from two DBS people who want to clear stations local to local. And if they're willing to pay, they will get them; if they are not, they will not. And it's important for us to be on DBS. But in our markets, we are the must-have station, for the most part. And if DBS wants them — and what I can't understand is that DBS could really kill cable if they aggressively came after the top stations in the market and negotiated a fair carriage and a promotional deal — it would **kill** cable. Cable's scared to death about it. And that might provide some leverage, then, for cable, which I think is going to happen as consolidation happens and local stations are becoming a more powerful entity over different platforms, they will be able to negotiate a fee for cable. But it isn't going to be for a while.

"**I** have calls from **two DBS** people **who** want to clear stations local to **local.** And if they're willing to pay, they will get them; if they are **not,** they will not."



Victor Miller: Let's talk about the expense side. This is, again, from the NAB. We have programming, production, news, general administrative, sales, engineering, advertising, and promotion. First, let's just generally talk about the staffing **of** a television station before we get into some of these costs — specifically, the percentages. Do these percentages look roughly right in the type sized markets that you're. . .?

Jim Yager: Yes.



	Market 1-10	Market 21.33	Market 41-50	Market 61-70	Market 81-90	Market 101.110	Market 121-130
Full-Time Employees	206	165	118	88	91	70	73
Revenue per FT Employee (000)	$553	$254	$178	$157	$147	$135	$104
Expenses per FT Employee (000)	$229	$144	$113	$93	$89	$80	$71

Source: NAB 2001 Television Financial Report

November 26, 2002

Victor Miller: Okay, let's look at the staffing. First of all, full-time employees of a station in markets **121-130 . . . 73,** roughly; in markets one through ten, **206.** Now, there seems to be a certain minimum level of expenses required to operate a TV station, while the largest market averaged, as we said, 200-plus employees, and markets **121** through **130** averaged just over **70 . . .** the big-market stations have 15 times more revenue, on average, and only have three times the employees. Is this true? And why is this? Peny?

Perry **Sook:** It may well be true. There is a certain minimum level of staffing if you want to provide full service. And I think the thing that across these companies is, we can comp **15** markets against each other, and you can get as close to a **. . .** almost a McDonald's franchise approach, that in markets **120** to 150, it's going to take **25-28** people to do news, and you need this many at master control. And I think you can very easily point out inefficiencies in your current group or in your acquisition targets. But from my perspective, once you cross that threshold, it's all about the revenue because your only incremental cost of doing business when you raise revenue is sales commission. So, it allows the wonderful margin and leverage opportunities that we have. But, again, I don't think your question is **. . .** the revenue per capita, I guess is kind of how? Profit per capita?

"It costs $3 million to run a network-affiliated TV station with a full news complement in markets 120-150."

Victor Miller: It's $104,000 per employee in markets **121-130** and **$553,000** in markets one through ten; it's about five times the level of revenue per employee.

Perry Sook: I think this ties back to the revenue per market, the average revenue per station that you kind of started the discussion with. So, I'm not sure that there's much more to be learned from this other than we haven't; it costs three million dollars to run a network-affiliated TV station with a full news complement in markets **120-150.** And it is just an absolute lower cost of operation. When you talk about **200** full-time employees in markets one to ten, I know that we can run a station with probably less than 73 people in markets 121-130. Then it's just a question of scale and specialized reporting.

"I think the key is not to look at the current model, which I don't believe we can sustain on the kind of profit margin we would like."

Jim Keelor: I think the key is not to look at the current model, which I don't frankly believe we can sustain on the kind of profit margin we would like. Since 2000, we have put a lot of time and money into inventing a new station model, as other broadcasters have; we're only about a third of the way there, and I know Paul's done some of this. Gary Chapman made the statement this morning that, maybe in Fort Wayne, they would end up with a news department and a sales department. I think that's exactly where it's going to go in our sized markets. Central casting and the hubbing and all of that is not cost-effective for many of us in these sized markets yet because the cost of fiber is too high. You can replace a $90,000 master control operator in Philadelphia — it's $25,000 in Lake Charles. That will eventually catch up. But what we are doing is regionalizing business managers. Where we once had 15, we eventually we will have six. The most controversial thing we're going to implement this year, as soon as we get a new traffic system, is regionalize our national sales managers. And we're not saving money by doing that. We are putting resources back into general sales managers and local sales managers because we must improve our revenue generation. And our reps have been very helpful, contrary to what you might think, and just as long as we've got the right people in the right jobs. So, if you think you can sustain the current model, good luck. You might be able to in a big market. But even the big guys, like NBC, are going to some sort of new business model; it's essential. We're doing it as aggressively as we can; we have an enviable balance sheet, which allows us to do it rapidly. And, in five years, we're not going to look anything, station structure-wise, like we look today.

"We are putting resources hack into general sales managers and local sales managers because we must improve our revenue generation."

Victor Miller: Mr. Yager?

Jim Yager: Yes, I think this is an interesting panel because the four companies represented here probably don't have a station — maybe one or two stations rank third in our markets — most of them are one or two. So, 1 think we are where the future of the small to midsized markets lies. What's not represented here is the third-, fourth-, and, in some cases, fifth-placed stations in the market. And, for them, I would question the future. I truly wonder what their position will be in four to five years. I don't see, in our sized markets, sustaining three or four news operations over the long term — even at these staffing levels. And if you can't do some of the things that Jimmy was talking about — this is kind of the evolutionary process of our business. Afternoon newspapers used to be a big thing across America. How many afternoon newspapers are left in this country today? They will eventually go away. That's why if you want to keep a number of kinds of outlets in the small markets, duopoly has to come . . . or some kind of terribly liberalized procedure for LMAs in our sized markets. I think it's not these four companies that are going to be in danger; it's the third- and fourth- and fifth-placed companies in their markets.

Victor Miller: Let's talk about programming a little bit. First of all — about news and production, I should say. Is this the station's biggest single cost? Are you adding more news programming in your markets? And why are you doing that? Paul, why don't we start with you?

Paul McTear: Yes, we are adding more news, but it's selective. Obviously, it's market by market; it's driven by competition and audience. I was startled to hear somebody earlier today say that they have started their morning news at 4:30. And actually, we just approved two television stations to do that in the budgeting process. And we also have launched in this budget process two weekend morning news in a middle-sized market with the consent of the network. The network was flexible enough to let us move around some of their shows. So, we've added people throughout last year and in this upcoming year in news and in sales and very little elsewhere because, based on what Jim has said, we are more dependent on infrastructure and technology; it's not cost-effective yet to tie multiple television station operations together because of the cost of connectivity as well as the low cost of labor that we have in our markets. But we have closed six back offices at this point — all of our Fox Television stations, we have six of them — their business offices are all run out of our largest Fox station in Cincinnati at this point. But news — we will continue to spend money. All of our stations, except for one or two, do editorials on the air. Again, that's part of the commitment we make to our community to serve it because, I think Perry said it . . . is we have 70-odd people in a market. We could probably run it with 60, but we would not provide the same level of service from the news and an editorial standpoint that we choose to do. To a point I made earlier about my cash needs. the fact that I have $8 million worth of new uses for cash next year as a result of DTV — it will be a great opportunity for us to take our news leadership in our markets . . . of groups similar to us and many them up with a weaker television station. That's probably a poor choice of words on my part. But a television station or a channel that has diverse demographics . . . that will enable us to leverage or get better utilization out of these costs, so that maybe on a combined basis, we're able to take a **31.6%** margin and make it somewhat more competitive and bring some new revenue in to offset the DTV costs going forward.

'We've added people throughout last year and in this upcoming year in news and in sales and very little elsewhere."

"It will be a great opportunity for us to take our news leadership in our markets and marry them up with a weaker television station."

Victor Miller: Are you guys also spending more or less on the news these days?

Jim Keelor: We're spending more because we . . . that's one of the reasons we kept our margins up is that we . . . I mean, when automotive is hot, political is hot, and you have the No. 1 news, you stand back and let it happen, and it's worth the investment. But I would like to comment on what Paul said. It's ironic that if we amortize the cost of that news over another station in the market, we could not only do that and help ourselves, but we could help the market. And we could program more diverse time periods; we could do a different type of newscast; we could actually provide what the commission would like to see happen — better public service in most of these stations that aren't doing much.

"It's ironic that if we amortize the cost of that news over another station in the market, we could not only do that and help ourselves but we could help the market."

Victor Miller: Perry?

Perry Sook: We're spending more money on news and more money **on** client development and sales promotion next year than we ever have in the past.

Jim Yager: As are we. News commitment is paramount to the local television news.

Victor Miller: Let's talk about the cost of the programming itself, your syndicated product. What do trends look like here? What do cash program payments look like in your markets? I imagine that, given the fact that you have fewer competitors, program payments should be a cost bright spot, I imagine, in your marketplace. Perry, do you want to start?

> "Once yon get outside the top **40** or **50** markets, you don't have a **full** contingent **of** all the networks represented It is an opportunity **for us** to leverage."

Perry Sook: Our cost for syndicated program expense **has** gone down a double-digit number in each of the last three years to the extent that next year we'll approach a level of ***6%* of** net revenues that would actually go for syndicated programming. Again, it is the positive leverage that we have that, quite frankly, when I was in the station business in Dallas, earlier in my career, we didn't have. We fought over barter programming to fill the air. Here, you've got the economics of the syndicated programming business are built to feed New York, Los Angeles, Washington's seven-plus commercial station markets. Once you get outside of the top 40 or 50 markets, you don't have a full contingent of all the networks represented — all the syndicated programming choices have not been exercised. So, it is an opportunity for us to leverage. And there's not a one of us here that has not added newscasts and dayparts, whether it be early morning, early fringe . . . and that takes up available time slots as well. And, by the way, we can sell news to advertisers at a higher unit rate and a higher cost per point than we can entertainment programming in those dayparts. ***So,*** there would be a natural bias toward increasing our news.

> **"We** try to take as many time periods away as possible from the syndicators, **not** because they're bad guys, it's just because they know how to cut really good deals when they have leverage."

Jim Keelor: We try, I think, to take as many time periods away as possible from the syndicators, not because they're bad guys, it's just because they know how to cut really good deals when they have leverage. *Dr. Phil* is a hit, Roger King's already doubled the price for two-year renewals, and he'll probably get it because there haven't been many hits in syndication. ***So,*** you're protecting your cost, you're providing the advertiser with a better advertising vehicle in local news. And, in the long term, that's your future. If we were in bigger markets, I'd be doing news from 4:00 in the afternoon until 7:30 at night, in some form.

Victor Miller: How are you approaching sales? How many more bodies are you putting into that? How much more are you emphasizing the sales side, and why do you think you need to bulk up there? And then, could you guys just comment on your **sales** efforts?

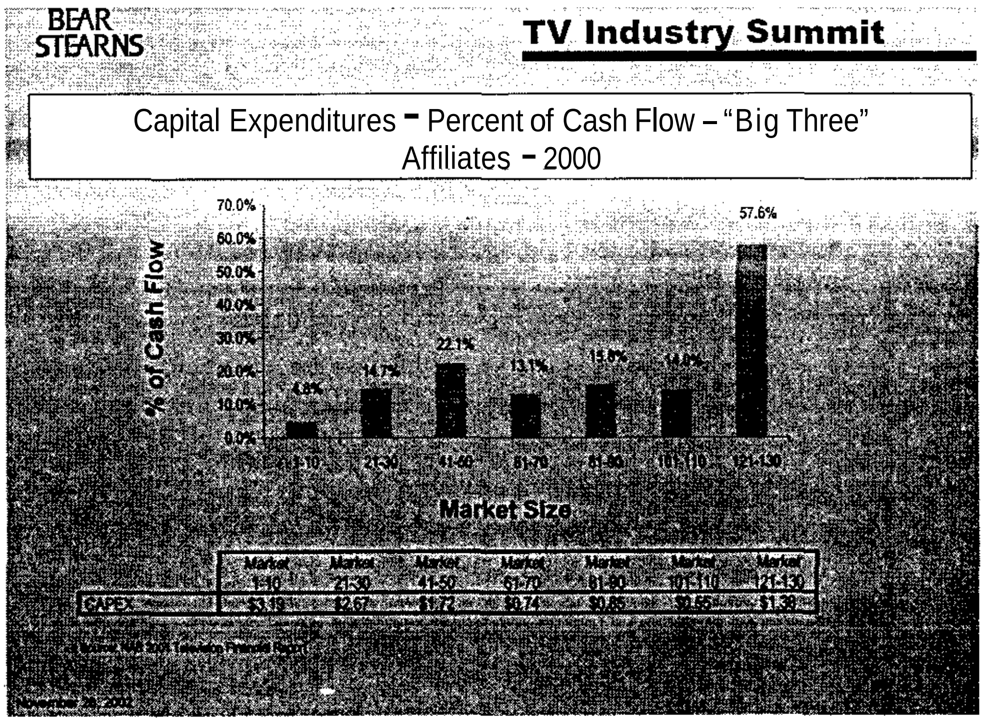
> "Ladies and gentlemen, this is still one hell **of** a business. Advertising is a tremendous business. We've just got to make sure we get our share. And the way to get our share is to improve our local share."

Jim **Keelor:** Well, quickly, it's amazing, when you **look** at all the diverse program choices that have been talked about all day, and you see the growth of the advertising pie in general. Ladies and gentlemen, this is still one hell of a business. Advertising is a tremendous business. We've just got to make sure we get our share. And the way to get **our** share is to improve our local share. ***So,*** what we've done is — I mean, there are not many markets in the 180th market that . . . whose sales staffs all have laptops and Blackberries and Goldmine software and Matrix software and have special sales training seminars twice a year — because we have to put the money in that. We have cut our way to where we can't cut any more unless we use technology to create **a** new model, which we're doing, **or** unless we reduce services. We are not going to reduce services and maintain our competitive market position. ***So*** we've got to do it with improved sates because nobody's going to give **us** additional shares — certainly not these guys where I'm competing against.

Victor Miller: Paul?

"2001 frightened us, and even before it was over, when we were doing 2002's budget, we decided that we'd try to make some changes."

Paul McTear: I agree with what Jim has said — 2001 frightened **us,** and even before it was over, when we were doing **2002's** budget, we decided that we'd try to make some changes. We have not, as a company, spent **a** lot of money or time on sales development. I think it's the same sales model year after year after year . . . sales compensation plans, etc. We decided to change that, **so** we actually budgeted an increase in fixed sales costs, with about *$2* million for our company. Where we had brought in some consultants whose sole purpose is to drive some development business in our markets, we've been very successful — combined with the political, has really enabled us to do a good job. What's the right number? I really don't know. But in Savannah, we probably have, 1 think, 15 people on the street in our CBS affiliate. So, in Memphis, we have probably about 20. It does vary by market, and it does vary—we do break it down into transaction teams and development teams. And I've been *successful in* doing it.



Victor Miller: Let's talk about capital expenditures. Here we have capex averaging **$3.2** million in markets one through ten, which is about **4.8%** of the average cash flow of that station. In markets **121** through **130,** the average was about **$1.38** million, or about ***58%*** of the cash flow generated by that station. Talk about the impact of digital television — obviously this is a main driver of this phenomenon, I imagine. Talk about how digital television is absorbing your cash flow and how you're handling that and what expectations you get in recovering that money that you're putting into that — if there's anything at all. Jim, do you want to kick **it** off, and we'll go to Perry?

"If you believe in television — free, over-the-air broadcast television — you have to make the investment in digital if you're going to be in this business in five years."

Jim Yager: **Yes.** Let me answer the last part of your question first. We have yet to **see** a model — and it was kind **of** interesting hearing Bruce Baker and Kevin and ***Gary*** talk about their conversion to digital —we have yet to see a model where we are going to realize much return on our digital investment over the next two to three years. The truth of the matter is, it's [digital TV] a cost of doing business. If you believe in television — free, over-the-air broadcast television — you have to make the investment in digital if you're going to be in this business in five years. Now, if you don't think there's a future, you ought to sell the station, in my simple view of things. We will develop good solid business models for our digital stations as we go forward, but we're not there yet. We still don't know about multicasting. We still don't know what relationships we're going to have with our own networks when it gets into a multicasting world. Those are still things that have to be worked out that we have not gotten over the hurdle yet. We were arguing as short a time as 18 months ago about a standard for digital. So, I mean, we were in large, long debates as to whether we were going to have 8VSB [8 vestigial side-band] or COFDM [coded orthogonal frequency division multiplexing] transmission standard. And then, do we have cable compatibility? Do we have a tuner that works in all digital sets, so that if you move from Washington, D.C. to Chicago, your set works? **Is** there cable interoperability with digital? Well, these are all hurdles that we're not over yet, but as we get over them, I believe, strongly, that the potential of this medium of digital television is — god, 1 wish I was **40** years old because I think the next **25** years are going to be a hell of a lot of fun in this business.

Victor Miller: Perry?

Perry **Sook:** I agree with Jim. The transition from black and white to color — and there was obviously a consumer demand for that — took **21** years start to finish. 1 don't know that the timetable we're looking at is . . . it's certainly not five years or four years from now. **So,** it's a part of our business plan. Twenty-six percent of our capital expenditures next year will go to complete the first phase of our digital transition, and we'll be on the air and legally compliant. And, by the way, our company agrees with Nat Ostroff of Sinclair Broadcast **Group** that we have no interest in having discussions about retransmission of our digital signal at the early phase and stage of it right now. And we certainly don't want to give it away. ***So,*** we'll be on the air with our first phase in all of our markets. It's a manageable number, but 1 believe that the whole process will be evolutionary going forward; it's going to be driven by a business model, it's going to be driven by consumer demand — set manufacturer and more programming. But that's going to take time, so our approach was to keep our capital outlay horizon as short as possible to see a return and also to keep our operating expenses as low as possible in terms of running these things at low power until **there** is some demand.

Victor Miller: Perry, you have local marketing and a lot of local marketing arrangements in your markets, which create essentially a virtual duopoly. Can you talk about why you've set these **up** and what kind of tangible improvement they've had in the second station that you've operated in those markets?

Perry Sook: Sure, the very first one [local marketing agreement] that we did was in the Wilkes-Barre/Scranton marketplace, and the station with which we have a sharing arrangement is the CBS affiliate in the marketplace. And when it was marketed in 1996, it was marketed as a money-losing station and the way to profitability was to eliminate the local news because it was the third-place station in town. It is now in the news business in a sharing arrangement with our NBC affiliate in the marketplace. We expanded the amount of news from 16.5 hours a week now to 21 hours a week of local content. And, by the way, 2002 will be the highest cash flow in the recorded history of that station. But literally, its news product would not be viable as a stand-alone basis. In Erie, Pennsylvania, we have an LMA, a grandfathered LMA, with a Fox station. We produce the market's only 10:00 news for that station, and with that station, there's a distinct identity, it is a newscast of convenience. That news would not exist without the overlay of our No. I-rated news from our ABC affiliate there. So, again, it's an opportunity, we think, for survival, for viability of stations three and below. And, by the way, the third-place station in that market is one of the big four networks. So, we argue that there probably shouldn't be any kind of a bright light test; this should be judged solely on marketplace sensitivities. And we think duopolies in big markets are all about money, and we're fine with that. But we think in the smaller markets, it's about a smaller amount of money, but it's also about survival. The unintended consequence of the two-class system is that ten years from now, all these stations in markets 50 and below were probably run out of big servers in New York, Chicago, Los Angeles, and there will be no localism. But we've increased the amount of local news. We've done in our duopoly markets by about 25% over that which we inherited because of the sharing of the resources of two TV stations.

"The unintended consequence of the two-class system is that ten years from now, all these stations in markets 50 and below were probably run out of big servers in New York, Chicago, Los Angeles, and there will be no localism."

Victor Miller: How many duopolies do you have now?

Perry Sook: We have six.

Victor Miller: How many, literally, you own . . .

Perry Sook: Legal duopoly? One.

Victor Miller: And you have five. . .

Paul McTear: And you've got five illegal.

Perry Sook: No! Five virtual duopolies.

Victor Miller: That was a slip, ladies and gentlemen. LMAs have been around for 20 years, so . . . you own two TV stations in one market [a duopoly] and the other ones are done through LMAs?

Perry Sook: That is correct.

Jim Keelor: Duopolies. We do not currently do duopolies. We would like to. We are discussing some, and we would like to. What we do . . . what we have done in three markets and looking for four is what we call a virtual station. For example, in Lafayette, Louisiana, we are the exclusive NBC signal out of Lake Charles. And we

have cut a deal with the cable friends as part of our retransmission where we feed our signal up to Lafayette and then we sell in that market as the NBC signal and station in the Lafayette metro and share that with the cable operator. And that's become a tidy little business for us in four markets.

Victor Miller: *Thank* **you.**